Statement by the Honorable Dale E. Hathaway
Under Secretary of Agriculture for
International Affairs and Commodity Programs
to the
Subcommittee on International Finance
Committee on Banking, Housing, and Urban Affairs
United States Senate
January 22, 1980

Mr. Chairman:

As the individual representing the Department of Agriculture, I will confine my testimony to the following points:

- o Why President Carter ordered the extraordinary action suspending agricultural trade with the Soviet Union;
- o what has been done specifically in that regard;
- o what steps have been taken by the United States to enlist the support of other nations which normally supply grains to the Soviet Union,
- o what has been done to offset the domestic impact of these actions, and
- o our assessment of the impacts of these actions on the USSR.

The suspension of U.S. agricultural exports was one effective and telling response to the Soviet invasion of Afghanistan, and, we believe, one which was not expected by the Soviets. Yet, as President Carter told Members of Congress, "We don't think that economic pressure or even condemnation by the United Nations of the Soviet Union will cause them to withdraw their troops."

Why Actions Were Taken

We had two options in responding to the Soviet Union: either disregard the importance of their action, or to demonstrate that such an act of unprecedented aggression would result in serious and costly countermeasures. The President chose the latter option, fully aware that the seriousness of our response clearly would have implications far beyond the immediate issue of Afghanistan.

U.S. agricultural trade with the Soviet Union in recent years has developed into one of the most important aspects of our relationship, so much so that it could not be ignored in responding to their military aggression.

This growing dependence was due in part to the unreliability of the weather in their crop production regions. Russian grain production is highly variable, ranging from a low of 140 million metric tons (mmt) in 1975/76 to a record high 237 mmt in 1978/79. In fact, 1979 production is 179 mmt, 58 mmt below 1978 and 48 mmt below their planned target. But more significantly, this dependence has been the result of a conscious decision by Soviet leaders to depend on grain imports to improve the Soviet people's diets. Despite variable grain production, the Soviets have maintained a commitment to increasing domestic consumption of livestock and poultry, and have achieved a 25 percent increase in meat production during the past decade. For this crop year, we believe the Soviets had intended to import a total of about 35 mmt of grains from all sources.

We could not support the continued improvement in Russian diets in the face of their invasion of Afghanistan. While another of my colleagues will review the legal aspects of our actions, I would only state our conclusion that the suspension of sales is in the national security and foreign policy interests of the United States, and our view that these actions must be placed in the context of our overall response to Soviet aggression.

<u>Specific Actions Taken</u>

In the non-agricultural area -- which my colleagues have discussed in detail with you today -- the President has:

- o asked Congress to defer action on SALT II,
- o delayed opening new American and Soviet consular offices,
- o deferred most economic and cultural exchanges,
- o called for U.S. withdrawal from the Olympics if the Soviet troops are not withdrawn from Afghanistan in a month,
- o ordered the review of U.S. licensing policy on the export of high technology, and temporarily halted such exports,
- o restricted severely the fishing privileges of the Soviet Union in American waters.

In the agricultural area, President Carter has:

- o suspended delivery to the Soviet Union of any U.S. grain in excess of the 8 million metric tons permitted under the terms of the 1975 U.S.-USSR Grain Supply Agreement,
- o suspended the contracts for delivery of oilseeds and products, livestock and products, poultry, and other strategically important items.

At the time the President ordered the suspension, the Soviet Union had contracts for delivery of U.S. grains from private exporters in this fourth year of the agreement totalling 21.8 mmt -- 6.7 mmt of wheat and 15.1 mmt of corn -- of which 5.5 mmt had already been shipped. In accord with Article II of the five-year U.S.-USSR Grains Agreement, President Carter indicated our intention to honor the 8 mmt figure, thereby permitting 2.5 mmt of grains bound for and already in port elevators to be loaded and shipped. However, as a result of the International Longshoremen Association's refusal to load this grain, this has not been done. However, we have worked with the Department of Commerce to issue licenses to exporters which allocate fairly among them the remaining tonnage up to the 8 million tons.

Trading in other products such as fruits, nuts, dairy products, animal fats, lumber and other agricultural products has also been halted. At present, the Administration has underway a complete review of the licensing of specific commodities to ensure that the President's action is upheld and the Soviets do not receive <u>any</u> items which could be substituted directly or indirectly and be of strategic importance to them.

<u>U.S. Steps to Enlist Support of Other Nations</u>

Parallel to these actions I've just described has been official U.S. consultations with other nations that export agricultural products to the Soviet Union.

On January 12, we met with representatives of Canada, Australia, the European Economic Community, and Argentina. Our purpose in meeting with their representatives was to solicit their cooperation.to not directly or indirectly replace grain which otherwise would have been shipped to the Soviet Union by the United States.

There is general agreement among the export representatives that their governments would not directly or indirectly replace the grain that would have been shipped to the Soviet Union prior to the actions announced by President Carter.

Canada, the European Community and Australia indicated their support of the United States, agreeing to our request that they not provide grains above those already committed to the USSR. In that regard, we had expected Canada to ship about 2 mmt of wheat and 500,000 metric tons of barley and oats to the USSR. Australia had been expected to ship about 2.5 mmt of wheat and 500,000 metric tons of barley. The European Community was expected to ship 350,000 mmt of wheat and perhaps 200,000 mt of barley.

The public statement of the Government of Argentina is well known. Nevertheless, in this meeting the delegation of Argentina stated that in no case does the Government of Argentina intend to take trade advantages from the present international situation. Neither will it seek to alter artificially the current demands of the different markets.

Export commitments by Argentina are much more uncertain since they are just beginning to export their new crop of wheat, while their current corn crop will not be harvested before April. It is clear to us that in the absence of a separate commitment from Argentina, some trade in grain will be replaced by this country. There is also the potential for direct and indirect transshipment of grains exported by cooperating countries to the Soviet Union. Finally, we would expect the Soviets to approach other exporting nations, especially Thailand and South Africa, for grain purchases. Our current estimate of the maximum quantities which might reach the Soviets as a result of direct or indirect transshipments from cooperating countries, and additional shipments for Argentina and other exporters is 1-2 mmt of wheat and 3-7 mmt of feed grains.

Under the most extreme conditions, the USSR would be able to import no more than 26 mmt of the 35 mmt which they had apparently hoped to import from all sources. About three-fourths of that deficit would be in feed grains.

In view of the Argentine statement, we will pursue other avenues in seeking cooperation with this country. Any action on their part to deliberately meet Soviet demand for grain lost by our suspension would clearly be short-sighted, and interpreted by other Western nations as undermining our collective actions.

We are concerned by the response from Argentina. Consequently, the United States and other cooperating governments have agreed to exchange information and participate in a comprehensive examination of trade flows in order to identify those who seek to provide substitutions and transshipments to the Soviet Union, and to take appropriate steps to counter such attempts to undermine our efforts.

With respect to oilseeds, the United States also approached Argentina and Brazil. Even though these commodities are far less strategic because of the volumes involved, we received assurances from both countries that they would not seek commercial advantage.

Offsetting Domestic Impacts of Actions

The actions ordered by the President to offset the domestic impacts resulting from the suspension of sales are best described in three stages.

First, there was the potential immediate impact of the suspension on grain market prices, on private exporters who had valid contracts, and ultimately on the entire grain marketing system of the United States. Approximately 4 mmt of wheat and 10 mmt of corn contracted for the Soviet Union were suspended from shipment, and contracts backing those quantities extended to local grain firms and ultimately to wheat and corn producers.

If these contracts had not been honored, many of the grain exporters would not have been able to meet financing commitments, and would have been forced to sell the undelivered grain at any price. Prices would have plummetted, causing millions of dollars in losses and bankruptcies throughout the grain marketing system, devastating our marketing system back to the local elevator and America's farmers.

To avert this, the United States, through the Commodity Credit Corporation (CCC), offered to assume the contractual obligations of exporters for the undelivered grain, the majority of which was corn.

We are now in the process of completing our review of the actual document and formula which will be used in such a transaction and hope to have it ready for negotiations with exporters late this week. I would add that we have taken -- and continue to take -- careful steps to ensure that contracts assumed by CCC do not guarantee profits to exporters in this assumption process. Our entire purpose is, as Vice President Mondale said, "to protect against losses, not guarantee profits."

Regarding corn, the CCC will either take physical delivery or sell the assumed contract to a third party for domestic or export usage. If physical delivery takes place, under current regulation the corn cannot be sold back into the market at a price lower than $3.15 a bushel at the farm. This is equal to 150 percent of the loan price, set by law in the 1977 Food and Agriculture Act. Assumed contracts will be sold only if the farm price is above the level of January 4, before shipments were suspended.

The CCC also will assume all of the contractual obligations for wheat earmarked for shipment to the Soviet Union. However, none will move back into the commercial market. Instead, it will be reserved for use in our foreign food assistance programs. Most of the wheat will be held in reserve for use when wheat supplies do not meet domestic and export needs.

To facilitate this action, President Carter will request the Congress to provide immediate supplemental funds to increase our foreign food assistance programs for the current fiscal year. The President once again reiterated his Administration's request for passage of legislation to permit the holding of up to 4 mmt of wheat in reserve for food assistance during periods of short supplies. While we have the authority to buy wheat now -- and we will -- we once again strongly urge the Congress to approve legislation to require any future Administration to use such grain to honor foreign food assistance commitments, no matter what the circumstances.

The second set of actions we have taken will isolate grain still owned by farmers from the marketplace.

The farmer-owned grain reserve -- the cornerstone of the Carter Administration's food and agriculture policies -- is being amended to encourage farmers to place additional grain in reserve instead of in the market. By offering greater incentives to farmers to participate in this program, the supply of grain available to the commercial market will be reduced and farm prices will be maintained.

Other specific actions taken by the Department include increasing:

- o the wheat loan price for the 1979 crop from \$2.35 to \$2.50 a bushel;
- o the corn loan price for the 1979 crop from \$2.00 to \$2.10 a bushel, with comparable increases in loan prices for the other feed grains;
- o the reserve release price for wheat from \$3.29 to \$3.75 a bushel-- which represents 150 percent of the new loan price;
- o the reserve call price for wheat from \$4.11 to \$4.63 a bushel, which represents 185 percent of the new loan price;
- o the reserve release price for corn from \$2.50 to \$2.63 a bushel, which represents 125 percent of the new loan price;
- o the reserve call price for corn from \$2.80 to \$3.05 a bushel, which represents 145 percent of the new loan price;
- o the reserve release and call prices for the other feed grains comparable to corn;
- o the reserve storage payments from 25 to 26.5 cents per bushel for all reserve commodities except oats, which is increased from 19 to 20 cents a bushel.

The Department is also waiving the first year interest costs for the next 13 million tons of corn entering the reserve.

The third set of actions consists of measures to expand U.S. grain exports in the short-term without reducing the exports of cooperating countries.

Last week we negotiated a sale to the Government of Mexico in which Mexico agreed to purchase an additional 4.8 million tons of U.S. agricultural commodities during 1980. The total 7.15 mmt will be about 1 mmt above what we had expected them to buy this year, and almost double what it purchased from the U.S. in 1979. This sale is significant because it is a cash sale at prevailing market prices with no cut-rate terms.

Last Saturday, President Carter announced that he was asking Congress not only to act quickly on his pending FY 1980 supplemental appropriation request of $96 million for food aid but to add another $100 million to permit us to program a portion of the grain previously sold to the USSR to meet urgent food needs of international refugees and poor people in selected less developed countries. The additional $196 million would permit us to increase grain and soya product exports this year.

The President also indicated that he would increase his FY 1981 P.L. 480 budget request by $100 million. That would provide for the export of an additional 450,000 tons of grain and soya products.

We have announced that the CCC non-commercial risk guarantee program for financing agricultural exports will be broadened in the near future to provide all-risk coverage. We have also raised the program level for guaranteed exports from $600 million to $1 billion. We will use the additional $400 million in credit risk guarantees to stimulate new exports as long as they do not replace our own commercial (cash) exports or disrupt markets for cooperating countries.

The fourth set of actions will consist of long-term adjustments in supply and demand. We are now identifying possible actions.

We are confident that the steps which have already been taken will offset the suspension's adverse impact on farmers now and in the near future; but to the extent we need them, we must have alternatives available to maintain farm prices at adequate levels over the long-term.

Let's now put the Soviet trade into perspective.

The total expected imports by the Soviet Union this year were only 3 percent of total world consumption of wheat and feed grains. In fact, during the past decade, U.S. exports to the Soviet Union ranged from 0 to 15 mmt.

Key factors for future U.S. exports will be our ability to encourage grain consumption in Eastern Europe, in advanced developing countries like Korea, Taiwan, Mexico, Brazil, and in developing countries generally. In other words, the fundamentals remain firm for exports of U.S. agricultural products in the decade ahead.

During Secretary Bergland's visit to China in November 1978, Chinese officials indicated they expected to import 10-12 mmt of grains each year. They also told him about half of these imports-- 5-6 mmt each year --would come from the U.S. At present, they have purchased less than 3 mmt in the U.S. We are expecting additional sales to China.

Japan and the European Community--both of which bought more of our products than the Soviet Union did--can be expected to maintain their high import levels this year.

I am therefore confident that fiscal year 1980 will be another record year for U.S. agricultural exports, despite the suspension. We are now projecting tonnage to be up from 137.5 mmt this past year to 146 mmt, and this total could go even higher as more countries move to buy the grain that is now available.

Also domestically, the Administration has sought to stimulate the production of grain for alcohol fuels, better known as gasohol. This could provide an additional, significant factor in future grain production and demand. The administration has announced a program to greatly expand (quadruple) gasohol production this year, and provide enough to replace 10 percent of the nation's supply of unleaded gasoline next year, primarily through tax incentives, loans and loan guarantees. This program alone could be a market for up to 3 mmt of grain by the end of 1980.

And, while we have announced that there would be no set-aside programs for 1980, we do have legal authority to offer a paid diversion program, if it were to become necessary. The new supply/demand situation will be released January 28. We expect to make a determination by not later than March 1.

We expect these measures to cushion any reduction in farm income that might have resulted from the Soviet suspension. U.S. net farm income has been forecast to decline about a fifth in 1980, primarily because of increased costs of production, especially energy. Reduced cash receipts for hogs and poultry also are a factor in the expected decline. We still expect sharp increases in costs this year and those increases will reduce farm income.

Market prices have withstood the effects of the suspension well. The markets moved down initially, and then came back up some. Prices for some commodities in some markets are still below pre-suspension levels, but we are convinced that they will return to levels at least as high as they would have been had we not taken the suspension action.

We have pulled out all the stops to make sure that the suspension does not alter supply/demand fundamentals. By isolating every bushel of grain destined for the Soviet Union, there is no more grain available for trade to other sources than there would have been had the grain been delivered.

Impact on the Soviet Union

As I previously stated, the 1979 grain crop in the Soviet Union was 58 million tons below the record amount produced last year, and 48 million below the plan amount. In consequence, the Soviets were forced to purchase a record quantity of grain in 1979/80 in an attempt to prevent distress slaughter of livestock, especially hogs and poultry.

In the summer of 1979, the Soviets began to make record purchases of grain in the face of poor livestock sector performance. The actual number of hogs and cattle slaughtered and slaughter weights were down in the latter half of 1979. Meat production was suffering and Soviet farmers were getting both verbal and monetary encouragement not to prematurely slaughter livestock. It had been assumed that record grain imports would lend massive support to the Soviet livestock industry until the 1980 grain crop became available.

According to data through November 1979, it appears both meat and milk production fell well-below plan, and actually declined from 1978 to 1979. Inventory data as of December 1 indicates a slightly smaller number of hogs than a year earlier, but all other livestock inventory levels were up from a year earlier. As of December 1, meat production in the socialized sector--accounting for more than 70 percent of total output--was down about 2 percent from 1978. Hog numbers on socialized farms, which had stayed above 1978-levels for most of the year, finally began to dip--dropping a half million head from December 1, 1978.

With declining livestock product output, the Soviets found themselves in a situation where dietary improvements could not be maintained. Given this situation, the suspension of shipments of 17 million tons is certain to have a significant impact on the USSR.

The suspension of grain sales to the USSR will sharply reduce the availability of grain to the Soviet livestock industry especially in the late winter and spring of 1980. While imports on an agreement year are expected to fall short of the 35 million tons before the trade restrictions

compared with 22 to 26 million tons after the restrictions, the main effect of the decrease will fall in the five-month period of March-July 1980.

We had forecast that the U.S. would supply 25 million tons, or three-fourths of Soviet grain imports during 1979/80. Following the suspension, our exports to the USSR will be limited to 8 million tons for the 1979/80 agreement year. Since grain moved strongly during the fourth quarter of 1979, our exports to the USSR between now and next October 1 will be only about 2.5 million tons, instead of the 19.5 million they expected.

Most major exporters have agreed not to offset the suspended U.S. exports. Some additional portion of the cutback from 25 to 8 million tons of U.S. exports may be offset by those exporters that do not cooperate with the United States' effort. Although the exact reduction cannot now be measured precisely, we believe there will be a sizable reduction in Soviet grain imports.

Last week, the Department published its first assessment of the effects of the suspension on Soviet feed balances and livestock production. We now estimate that use of grain for feed during 1979/80 will drop at least 5 percent from the pre-suspension forecast. The reduction in grain fed will be exacerbated by its concentration during the late winter, spring and summer months. This is the period when U.S. exports will cease due to the trade suspension and when the Southern Hemisphere production is moving into position for export. Consequently, the relative shortfall during this period will be more severe, and may force a reduction in hog and poultry numbers. The dislocations caused in transport and location of feed supplies also may worsen production performance.

Soviet meat production in 1980 could be down significantly from 1979 output. Any downturn in Soviet meat production would result in reduced per capita consumption unless offset by meat imports. Meat consumption has stagnated at about 57 kilograms (125 pounds) per capita since 1975, following rapid growth during the first half of the 1970's. The prospective drop in 1980 meat output could be expected to lower consumption roughly by 4 percent and aggravate the concerns of Soviet consumers expecting further improvement in meat supplies.

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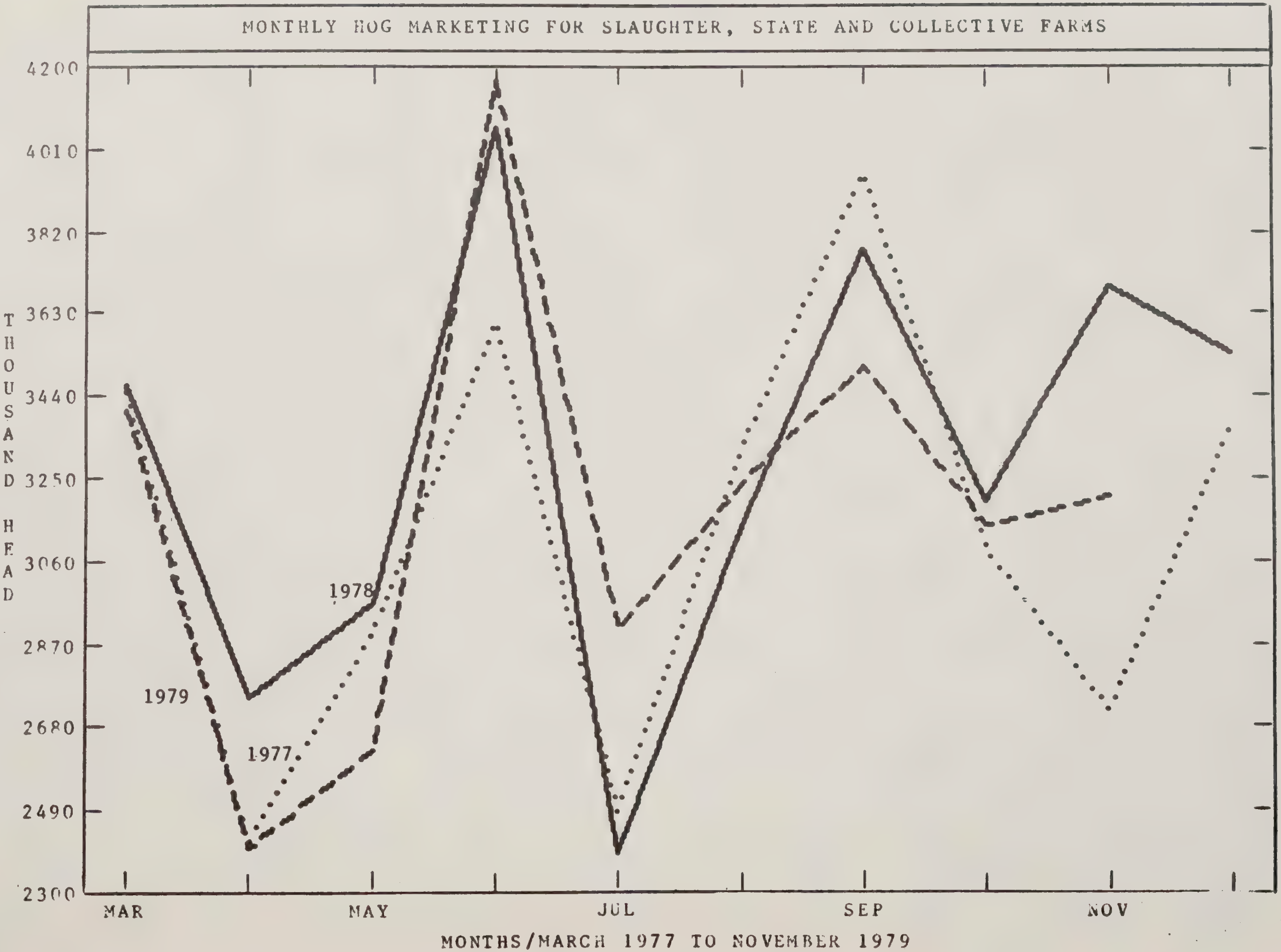
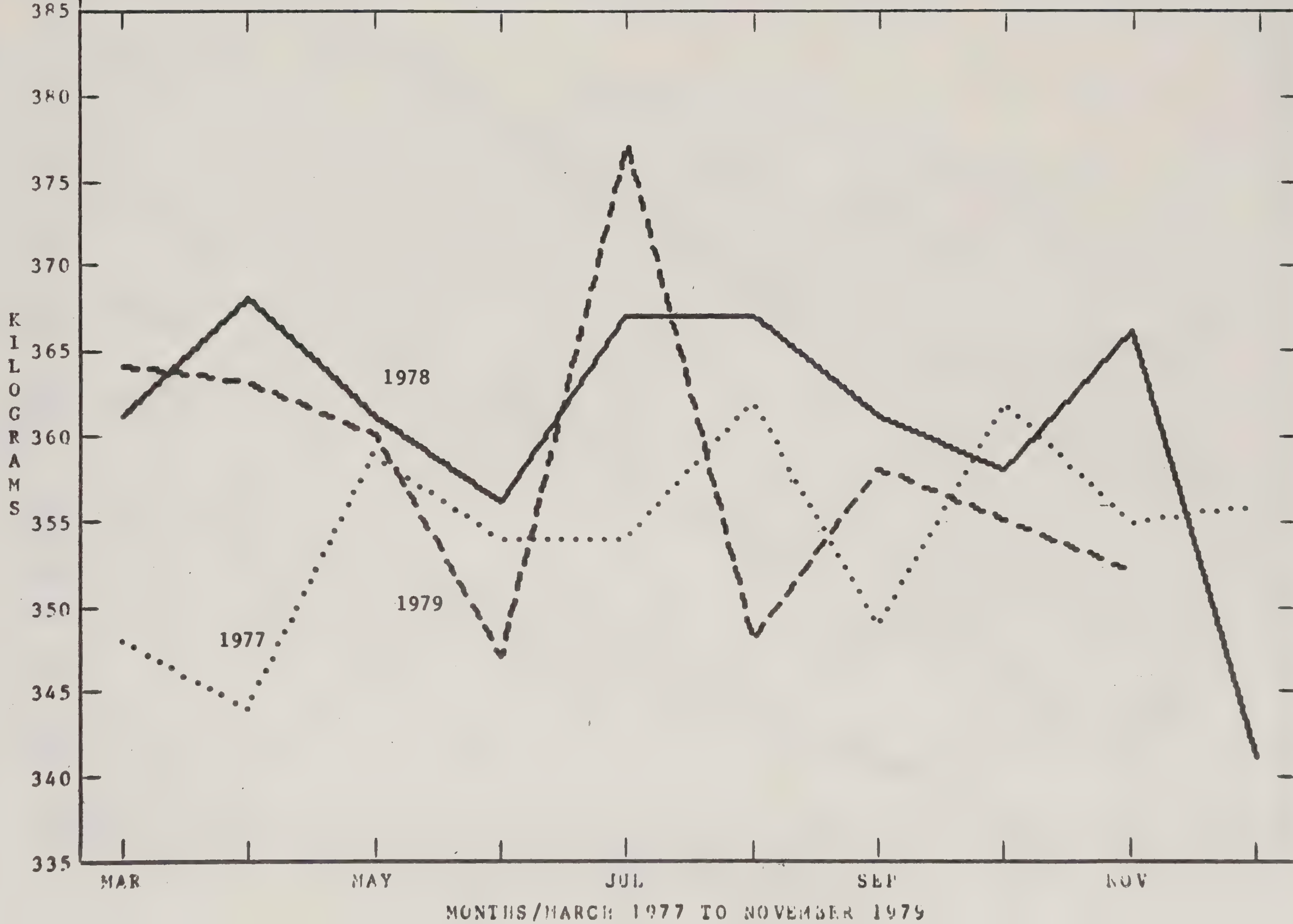
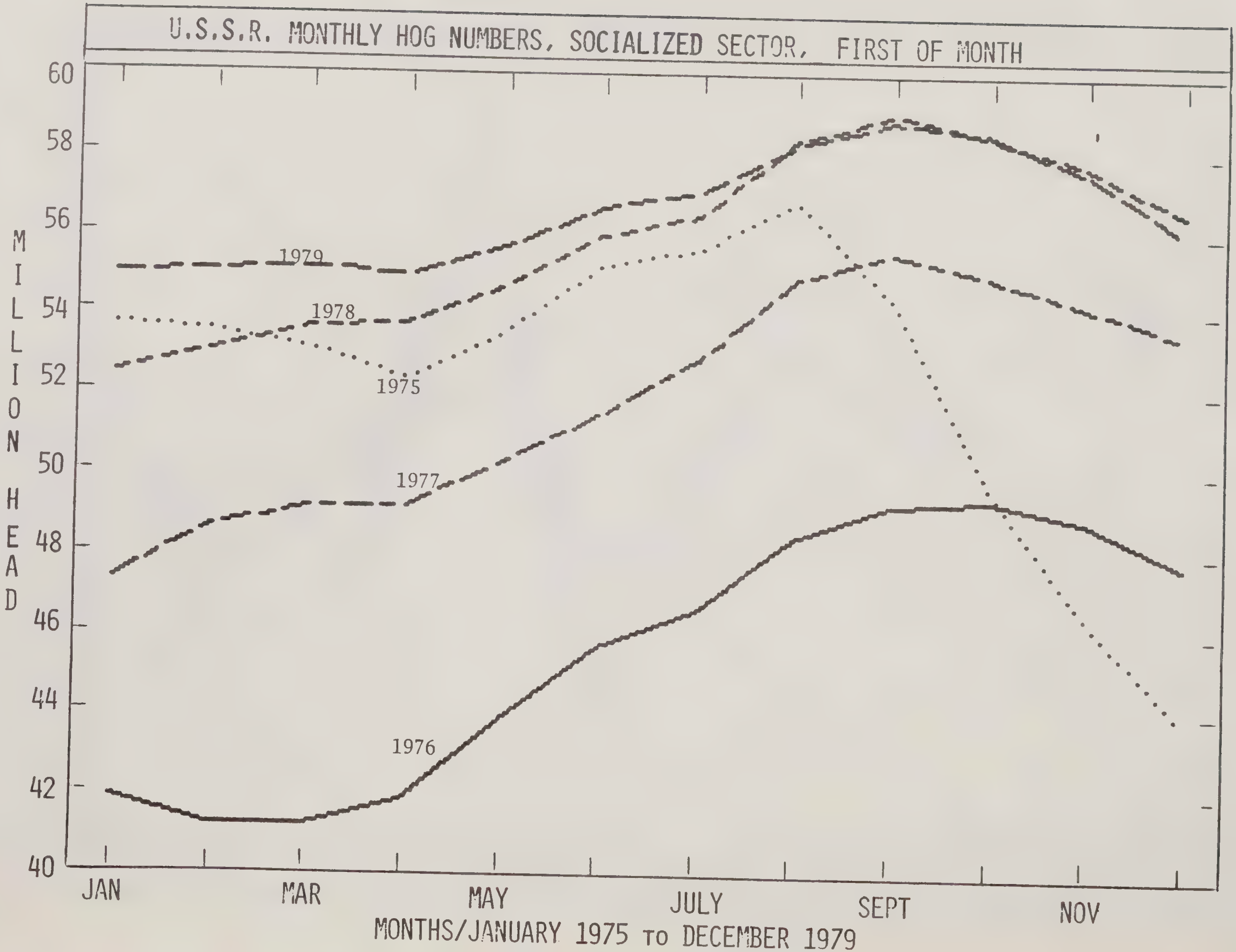
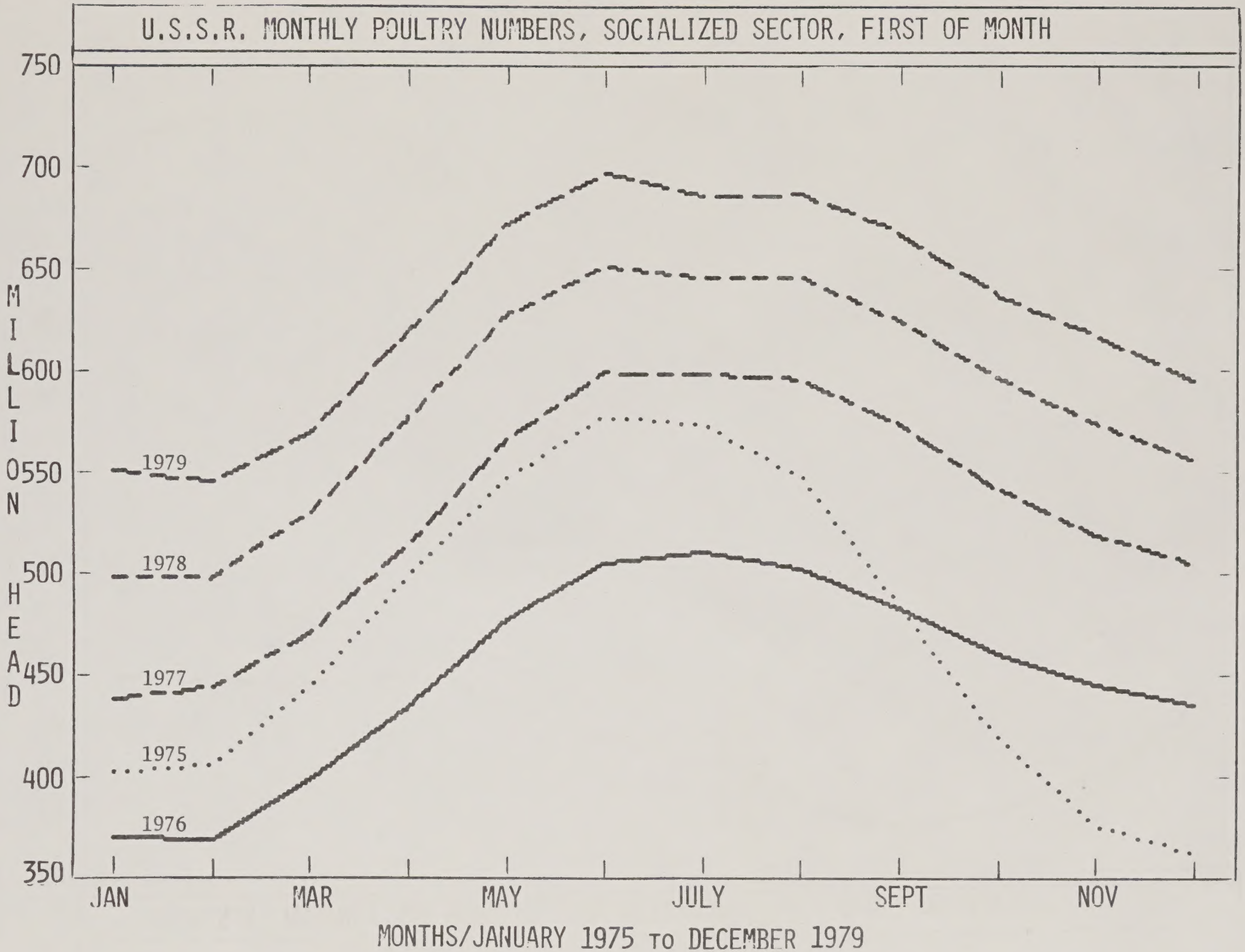

MONTHLY HOG MARKETING FOR SLAUGHTER, STATE AND COLLECTIVE FARMS
THOUSAND HEAD
4200
4010
3820
3630
3440
3250
3060
2870
2680
2490
2300
1978
1979
1977
MAR
MAY
JUL
SEP
NOV
MONTHS/MARCH 1977 TO NOVEMBER 1979

CATTLE FOR SLAUGHTER, AVERAGE LIVEWEIGHT, STATE AND COLLECTIVE FARMS




U.S.S.R. MONTHLY HOG NUMBERS, SOCIALIZED SECTOR, FIRST OF MONTH
MILLION HEAD
60
58
56
54
52
50
48
46
44
42
40
1979
1978
1975
1977
1976
JAN
MAR
MAY
JULY
SEPT
NOV
MONTHS/JANUARY 1975 TO DECEMBER 1979


U.S.S.R. MONTHLY POULTRY NUMBERS, SOCIALIZED SECTOR, FIRST OF MONTH
MILLION HEAD
750
700
650
600
550
500
450
400
350
1979
1978
1977
1975
1976
JAN
MAR
MAY
JULY
SEPT
NOV
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